USPS-T-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

EXPERIMENTAL PRESORTED PRIORITY MAIL RATE CATEGORIES, 2001	:	Docket No. MC2001-1

TESTIMONY
OF
THOMAS M. SCHERER
ON BEHALF OF
UNITED STATES POSTAL SERVICE

TABLE OF CONTENTS

List of Attachments

TESTIMONY
OF
THOMAS M. SCHERER

AUTOBIOGRAPHICAL SKETCH

My name is Tom Scherer. I joined the Postal Service in March 1999 as an Economist in the Pricing Department. This is my first appearance as a witness before the Postal Rate Commission.

Before joining the Postal Service, I worked for 16 years as a financial and economic analyst. I started my career as a financial analyst at American Can Company. My responsibilities there included capital budgeting and investment analysis, product costing, and working capital management. I then worked for 11 years as an economic/financial analyst for JACA Corp., an environmental engineering and consulting firm. At JACA, I performed regulatory economic impact analysis for the U.S. EPA and OSHA in support of the development of about a dozen new air emissions and workplace exposure standards. I also provided expert witness services to the EPA by determining – with discounted-cash-flow analysis – the ability of noncomplying companies to pay civil penalties in about 30 different regulatory enforcement cases. In the year prior to joining the Postal Service, I worked as a steel industry analyst for CRU International, a commodities research firm.

I received a BA in Economics with High Honors from Oberlin College in 1980, and an MBA in Finance from The Wharton School, University of Pennsylvania in 1982.

I. Purpose of Testimony

The purpose of this testimony, along with the testimony submitted by Witness Levine (USPS-T-2), is to present the Postal Service's proposal for an experimental Priority Mail presort discount. My testimony presents the rationale for a presort discount, for an experimental designation, and for limiting participation – at least at the outset of the experiment – to a small, manageable number of mailers. In addition, I will explain the Postal Service's rationale for proposing a Priority Mail presort discount after a different Priority Mail presort discount was eliminated in Docket No. R97-1. Also in this testimony, proposed discounts are derived with reference to the cost-avoidance estimates in Witness Levine's testimony; volume and financial impacts are estimated; and conformance of the proposal to the statutory criteria for experimental rules, classification changes and rate/fee changes is demonstrated.

II. Proposal

A. Description

The Postal Service proposes to create an experimental classification to offer a Priority Mail presort discount to a limited number of mailers. A three-year duration for the experiment is proposed. Mailers will be able to choose from among three presort levels: ADC[1], 3-digit and 5-digit. The proposed per-piece discounts are 12¢ for an ADC sort, 16¢ for a 3-digit sort, and 25¢ for a 5-digit

[1] ADCs, or Area Distribution Centers, process and distribute certain mail, including Priority Mail, destined for designated ZIP Code areas.

sort. The discounts apply equally to flats, parcels and "outsides."[2] The minimum quantity requirement per mailing is 300 pieces or 500 pounds.

B. Mailer Eligibility

The proposed Priority Mail presort discount will be available to customers who can meet the minimum quantity requirement above, as well as mail preparation and containerization requirements that will be similar to requirements for worksharing discounts in other mail classes. Some restrictions will apply. The Postal Service will aim to extend the presort discount to roughly 10 mailers in the first year to year-and-a-half of the experiment. This number of mailers will permit manageability during implementation of the experiment. Priority Mailers have diverse characteristics – some mail flats, others parcels; some have their mail shipped by surface transportation, others by air transportation. As a result, it will be necessary, during implementation, for postal personnel to work out mail preparation and containerization requirements individually with customers. A limit of 10 or so customers will help to ensure that this implementation process is orderly and manageable.

The limit of 10 or so customers will also prevent the discount from being offered too widely before it can be determined, in Phase I of the Data Collection Plan (see Attachment A to Witness Levine's testimony), that the experiment is running well – in particular, that there are no unforeseen difficulties in implementing the discount, that there are no unforeseen additional costs, and that presorted mail is actually avoiding the postal operations it was assumed to

[2] An outside is a mail piece that does not fit in a Priority Mail sack, weighs over 35 pounds, or contains live animals.

avoid. If such a determination is made, the Postal Service – consistent with our ability to administer the program – envisions expanding beyond the initial cohort of 10 or so mailers in the second and/or third years of the experiment if there is additional mailer demand for the presort discount.

To learn as much as possible from the experiment, the Postal Service will seek participants of diverse size, location and mail characteristics (e.g., shape). Geographical dispersion, in particular, may be necessary if the clustering of participants in any one area of the country would overburden postal District personnel with implementation responsibilities.[3] The Postal Service also has a preference for customers who are willing to work closely with postal District personnel to coordinate mail preparation and containerization changes, and who will present presorted mail on a regular or continuing basis, rather than infrequently or sporadically. The Postal Service believes that the limit of 10 or so mailers at the beginning of the experiment will allow for sufficient mailer diversity to make the experiment's results meaningful.

C. Rationale

1. For a Presort Discount

The primary reason for proposing a presort discount for Priority Mail is – as with other forms of worksharing – to promote economic efficiency. The proposed discount will give mailers an incentive to presort if they can do so for less than it costs the Postal Service to sort. This promotes an efficient allocation

[3] These responsibilities include working out mail preparation and containerization requirements with customers. Such requirements vary with local conditions, for example the location of the customer vis-à-vis postal processing and distribution facilities, or the mode of transportation –

of resources because the least-cost mail processor performs the sorting (freeing up resources for other uses), lowering total (public + private) costs to society. Priority Mail currently stands out from other major types of mail – First-Class, Standard Mail, and Periodicals – as not having worksharing.

The current proposal comes after the elimination of a different Priority Mail presort discount in Docket No. R97-1. That discount, which was introduced in Docket No. R90-1 and which in all years accounted for between 0.6 and 0.9 percent of total Priority Mail volume, required mailers to sort to the finest level – in turn, 5-digit, 3-digit, SCF, and ADC – permitted by their densities. At the time of its elimination, the discount was a flat 11¢ per piece regardless of the level of presort. In requesting its elimination in Docket No. R97-1, the Postal Service cited the low mailer response and the (then) impending implementation of the PMPC processing and distribution network. Concurring, the Postal Rate Commission recommended removal of the discount from the Priority Mail classification schedule. PRC Op., R97-1, at 355.

The Postal Service believes that the proposed new Priority Mail presort discount will be more attractive to mailers than the discount eliminated in Docket No. R97-1. (See also the testimony of Witness Kalenka, USPS-T-3, Footnote 3.) The old discount offered limited flexibility, with density-based sequential sorting requirements starting at 5-digit, followed by 3-digit, followed by SCF, followed by ADC. This may have accounted greatly for the low level of mailer interest. The

surface or air – used by the Postal Service to ship mail to its destination (which, among other things, affects whether the mail can be palletized).

new proposal's added flexibility – with three sort options (5-digit, 3-digit and ADC) – promises greater likelihood of a cost-effective solution for mailers.

The time is also right for reintroduction of a Priority Mail presort discount. On January 7, 2001, the Postal Service took over management of the PMPC processing and distribution network after the operating contract with Emery Worldwide Airlines was terminated. While integration of this network is not yet complete, the Postal Service, which now has control of the sorting operations that can be bypassed upon receipt of presorted mail, should be in a better position to capture savings from presorting. The previous contractual relationship with Emery was based on fixed per-piece payments to the contractor. This significantly reduced the Postal Service's potential to realize savings from presorting.

There are two additional, secondary reasons for the proposal. First, in the wake of a 16% average recommended rate increase for Priority Mail in Docket No. R2000-1, the proposal offers some measure of rate relief. Of course, mailers must incur mail preparation costs in order to obtain the rate relief. And the rate relief will be limited to those mailers who participate in the experiment. However, should the experiment demonstrate the usefulness and desirability of a Priority Mail presort discount, the Postal Service would expect to propose a permanent classification at the end of the experiment, extending eligibility to additional mailers.

Secondly, as in the cases of Bulk Parcel Return Service (Docket No. MC97-4) and Non-letter-sized Business Reply Mail (Docket No. MC97-4, USPS-

T-3), a classification aimed at a limited number of mailers may help the Postal Service to better meet the needs of individual customers.

2. For an Experimental Designation

An experimental classification would allow the Postal Service to evaluate the cost benefits of presorted Priority Mail and to determine if the proposed discount structure provides correct incentives to the mailing community. In particular, several sources of uncertainty could be resolved before considering a permanent classification for a Priority Mail presort discount. First, with relatively little mailer interest in the old presort discount, it is uncertain how mailers will respond to a new discount (though the Postal Service believes the new offering is more attractive). The Postal Service would benefit from an experimental period during which the response to the discount could be monitored and evaluated.

Second, presort mail may turn out to have characteristics differing from the overall Priority Mail population. One mail characteristic that warrants particular observation is the shape mix, i.e., flats vs. parcels. Postal Service sorting costs for flats and parcels may differ depending on the extent to which operations are mechanized or manual. Bypassing sorting operations could therefore save the Postal Service different amounts for flats and parcels. Without foreknowledge of mail characteristics such as the flats-parcels mix, and of the specific types of sorting operations that will be bypassed for flats vs. parcels, the Postal Service would benefit from the opportunity – as afforded by the experimental rules – to collect data and evaluate implications for cost savings.

Integration of the PMPC network into postal operations presents a third source of uncertainty. The Postal Service took over management of this network – after termination of the PMPC contract with Emery – on January 7, 2001. It will take some time, however, before integration is complete. In the meantime, there could be implications for cost savings realized from presorting. In addition, the cost avoidance estimates in Witness Levine's testimony rely on Postal Service data that are mainly exclusive of the PMPC network. An experimental filing would give the Postal Service the time and means to monitor and evaluate the effects of integrating the PMPC network.

D. Cost Pass-Throughs

The proposed discounts of 12¢ for an ADC sort, 16¢ for a 3-digit sort, and 25¢ for a 5-digit sort follow from a 60 percent pass-through of the cost avoidance estimates in Witness Levine's testimony. All discounts are rounded to the nearest cent, consistent with base rates in the Priority Mail rate schedule.

The conservative pass-through percentage I employ is appropriate given several perceived risks with respect to the Postal Service's ability to fully realize estimated cost savings from presortation. These risks are discussed below. At the same time, I was also mindful that the Commission and Postal Service are not in accord on the most accurate measure of avoided costs. For example, I am informed that the cost avoidance estimates provided to me would be significantly lower if the Postal Service's approach to estimating the volume-variability of mail

processing costs had been used.[4] Since a principal concern of my analysis is to avoid setting discounts that are excessive compared to estimated avoided costs, I viewed this dispute over the most accurate measure of avoided costs as yet another reason – in addition to the risks discussed below – for choosing a conservative pass-through.

The first risk with respect to fully realizing estimated cost savings is that presort volume may have different characteristics from the overall Priority Mail profile. The cost avoidance estimates in Witness Levine's testimony reflect nationwide averages for Priority Mail characteristics, including the nationwide mix of flats and parcels, which favors parcels. However, presort volume may have a different flats-parcels mix, which could affect the savings realized from presorting depending on the way flats and parcels are currently sorted. Uncertainty about the characteristics of presorted Priority Mail and their implications for cost savings warrants mitigation of the cost pass-through. During the course of the proposed experiment, presorted mail characteristics, including shape mix, will be observed, and their implications for cost savings will be evaluated.

A second mitigating factor is that the Postal Service has limited experience with Priority Mail worksharing. Other mail classes, such as Standard Mail, have worksharing systems in place that can inform the development of new worksharing proposals. For example, benchmarks may be available for new cost avoidance estimates. Currently Priority Mail has no worksharing, and the presort experience of the 1990s, due to the low mailer response, offers little in the way of

[4] As disclosed in Attachment E to Witness Levine's testimony, cost avoidance estimates using the Postal Service's volume-variability methodology are approximately 57 percent of those using the

instruction. This increases the risk that estimated cost savings will not be captured.

Another mitigating factor is that the Postal Service is currently in the process of integrating the PMPC network into its operations. Before this process is completed, there could be effects on cost savings realized from presorting.

Finally, Witness Levine's cost savings model only considers avoided piece distribution costs. It does not take into account any changes in cost that could arise from the proposed presort discount's containerization requirements. For example, the containerization requirements could lead to an increased number of container handlings and less efficient use of transportation space. This further warrants mitigation of the cost pass-through.

E. Volume and Financial Impacts

One of the reasons, in the first place, for proposing an experimental classification for the new Priority Mail presort discount is that its volume and financial impacts are difficult to predict. However, it is possible to make some judgments about these impacts.

As mentioned earlier, presort mail accounted for anywhere from 0.6 to 0.9 percent of total Priority Mail volume in the fiscal years after introduction of the old presort discount in Docket No. R90-1 until its elimination in Docket No. R97-1. The Postal Service believes that the proposed new presort discount's flexibility of three sort options (5-digit, 3-digit, or ADC) will attract more mailer interest than the sequential sorting requirements (depending on mail densities) of the old discount. I therefore posit that, compared to the old presort discount, relative

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Commission's methodology.

mailer interest in the proposed presort discount will double to 1.2 - 1.8 percent of total Priority Mail volume.[5] As a point estimate, I choose the midpoint, 1.5 percent.

This factor, 1.5 percent, will yield an annualized volume impact when multiplied by projected total annual Priority Mail volume. Multiplying by Test Year (FY 2001) volume will overstate the Test Year impact because the Test Year is already underway. In the calculations that follow, which are summarized in Attachment A, the simplifying assumption is made that Test Year (Fiscal 2001) data can be used to estimate annualized impacts. In reality, the impacts I am estimating apply more appropriately to the first year after implementation rather than the Test Year.

Multiplying the 1.5 percent by Postal Rate Commission Test Year After Rates (TYAR) total Priority Mail volume of 1,243.245 million pieces yields **18.6 million pieces** that will shift to the proposed presort discount in the Test Year. Docket No. R2000-1, Appendix G, Schedule 1. In addition to these shifting pieces, total volume will increase slightly as a result of the discount. This volume impact depends on a) the price elasticity of demand for Priority Mail – -0.819 in Docket No. R2000-1 (USPS-T-8, at 21) – and b) the discount offered to customers, net of their costs to presort. Without foreknowledge of the distribution of volume by sort option (which is one of the reasons for proposing an experimental classification), it is assumed that each sort option will be equally popular: one-third ADC, one-third 3-digit, and one-third 5-digit. This results in an

[5] This forecast need not be constrained by the proposed discount's limited availability to roughly 10 mailers. Use of the old discount was highly concentrated in just a handful of mailers.

average discount of 17.67 cents, or 3.9 percent off average realized revenue per piece in the TYAR of $4.57.[6] Docket No. R2000-1, Appendix G, Schedule 1.

Now, the average 3.9 percent discount cannot be applied directly to the elasticity estimate to derive the volume impact because participating mailers will incur additional costs to qualify for the discount. Without knowledge of customer cost functions, these additional costs are unknown. In theory, customers should be willing to incur additional costs in order to obtain the discount as long as the costs do not exceed the discount. Some customers may be "close to the margin," where additional costs equal the discount, while others may have additional costs that are significantly below the discount. It is assumed here that average net savings to the customer – i.e., the discount net of presort costs – are half the level of the discount. The impact on volume of offering an average 3.9 percent discount to 18.6 million pieces of baseline volume can then be expressed as:

$$\Delta V = V_1 \times \%\Delta P/2 \times e$$

where,

ΔV = change in volume

V_1 = baseline volume = 18.6 million pieces

$\%\Delta P$ = percent change in price = -3.9 percent

e = price elasticity of demand = -0.819

Solving, volume increases by approximately **295,000 pieces**. This is only 0.02 percent of the 1,243.245 million in TYAR volume.

[6] Using average realized revenue per piece assumes presorted pieces have, on average, the same weight, shape, and zone characteristics as the overall Priority Mail population. Such characteristics are in fact not known for presorted pieces, which is a major reason for proposing the classification as an experiment.

Revenue impacts follow from the above volume impacts. Revenue will decline from application of the discount to the estimated 18.6 million of TYAR volume. At an average discount of 17.67 cents per piece, that effect is -$3,295,000, only 0.06 percent of $5.7 billion in TYAR revenue. Docket No. R2000-1, Appendix G, Schedule 1. This is partly offset by revenue deriving from the 295,000-piece volume increase. Average realized price for that volume is the TYAR average realized revenue per piece of $4.57, minus the average discount of 17.67 cents per piece. That is $4.3933 per piece, which applied to 295,000 pieces produces $1,297,000 in revenue. Another revenue offset, albeit very small, derives from a $125 annual presort fee that will be collected from mailers who participate in the experiment. At an estimated 10 mailers, total fee revenue is $1,250. The net revenue impact of the proposed presort discount is therefore -$3,295,000 + $1,297,000 + $1,250, or approximately **-$2.0 million**. This represents only 0.04 percent of TYAR revenue.

Total cost impacts are as follows. In Witness Levine's testimony, the per-piece cost-avoidance calculations are 19.3 cents for an ADC sort, 26.1 cents for a 3-digit sort, and 42.0 cents for a 5-digit sort. Assuming, again, an equal distribution of the three sort options, the average cost avoidance per piece is 29.1 cents. Applying to the 18.6 million shift in TYAR volume yields $5,433,000 in total TYAR cost savings. This represents only 0.15 percent of $3.5 billion in TYAR total attributable cost. Docket No. R2000-1, Appendix G, Schedule 1. As in the revenue impact calculation, there is an offset deriving from the 295,000-piece volume increase. Average attributable cost per piece for that volume is the

TYAR average of $2.823 ($3.5 billion in total attributable cost, divided by 1,243.245 million in volume), minus the average cost avoidance per piece of 29.1 cents, or $2.532 per piece. This produces $747,000 in additional attributable costs from the 295,000 in additional volume. The net total attributable cost impact of the proposed presort discount is therefore -$5,433,000 + $747,000, or approximately **-$4.7 million**. This represents only 0.13 percent of TYAR total attributable cost.

Total contribution (to institutional costs) increases by the change in revenue minus attributable cost: -$2.0 million - (-$4.7 million) = **+$2.7 million**. There are two reasons for the increase: the less than 100 percent pass-through of cost savings, and positive contribution on the additional 295,000 in volume. The increase is only 0.12 percent of TYAR total contribution ($5.7 billion - $3.5 billion = $2.2 billion).

Cost coverage also increases – just slightly. In the TYAR, it is 161.9 percent ($5,680.3 million ÷ $3,509.3 million). Docket No. R2000-1, Appendix G, Schedule 1. After the proposed presort discount, it is ($5,680.3 million - $2.0 million) ÷ ($3,509.3 million - $4.7 million) = **162.0 percent**.

See Attachment A for a summary of these calculations.

III. Compliance with the Section 3001.67 Experimental Rules

A. Novel in Nature

Presorting is clearly not novel, per se, but the current proposal for a Priority Mail presort discount is novel in at least two ways. First, it would reverse a decision to eliminate another Priority Mail presort discount (in January 1999,

pursuant to Docket No. R97-1) after only a little over two years. Secondly, the new discount is being proposed at a time when the Priority Mail processing and distribution network is in flux, with the PMPC network currently being integrated into postal operations.

B. Magnitude of Proposed Change

The proposed Priority Mail presort discount should have minimal impacts on "postal revenues, postal costs, mailer costs, and competition." In Section II.E the net postal revenue impact was estimated at -$2.0 million, only 0.04 percent of TYAR total Priority Mail revenue. Postal cost impacts are similarly minimal: -$4.7 million, only 0.13 percent of TYAR total Priority Mail attributable cost.

Presumably mailers will choose to presort (and take the discount) only if postage costs decrease by at least as much as the increase in mail preparation costs. Their net costs do not increase. Such an impact on mailer costs is considered minimal.

As discussed in Section II.E, the proposed presort discount is estimated to apply to 18.6 million pieces of existing Priority Mail and to also prompt volume growth of 295,000 pieces. The growth is expected to come from existing postal accounts, which will be targeted in the experiment. However, potentially some customers participating in the experiment would, in the absence of the discount, have sent some of their volume to a Postal Service competitor. Even in the extreme, though, if all 295,000 new pieces were to come from competitors, the impact on competition would be minimal. Priority Mail competes in the two- to three-day package and document delivery market. It is my understanding that the

size of this market is approximately 2 billion pieces per year. The 295,000 additional pieces that may accrue to the Postal Service would represent only 0.01 percent of this total. Such a minor impact on share cannot be said to affect competitive balance in the market.

C. Data Generation

Data on volume (by sort option and shape), revenue, costs, sortation schemes, et. al. will be collected during the course of the experiment. The data will be needed to evaluate a) the merits of expanding mailer eligibility beyond the initial cohort of 10 or so mailers in the second and/or third years of the experiment, b) the merits of establishing a permanent classification for a Priority Mail presort discount at the end of the experiment, and c) whether mail preparation requirements need any modifications. Among other things, the data will be studied to assure that cost savings are being captured. For more on data collection, please see Attachment A to Witness Levine's testimony.

D. Duration of Experiment

The Postal Service requests that the Commission recommend a three-year duration for the proposed experiment. This will give the Postal Service adequate time to attract customers to the discount; to consider, during the course of the experiment, expanding eligibility beyond the initial cohort of 10 or so mailers; and ultimately to evaluate the merits of establishing a permanent classification for the discount before the end of the experiment. Accordingly, the two phases in Witness Levine's Data Collection Plan (see Attachment A to his testimony) are estimated to take about three years.

IV. Classification Criteria

Section 3623(c) of Title 39, U.S.C. requires the Postal Rate Commission, when issuing a recommended decision on a Postal Service request for a classification change, to consider the following factors:

1) the establishment and maintenance of a fair and equitable classification system for all mail;

2) the relative value to the people of all kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;

3) the importance of providing classifications with extremely high degrees of reliability and speed of delivery;

4) the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;

5) the desirability of special classifications from the point of view of both the user and of the Postal Service; and

6) such other factors as the Commission may deem appropriate.

The proposed Priority Mail presort discount is fair and equitable (Criterion 1). It rewards customers who are able to sort mail at lower cost than the Postal Service. It will be available to all applicants who can meet minimum quantity, mail preparation and containerization requirements, regardless of size or line of business.[7] Furthermore, the proposed conservative cost pass-through of 60 percent guards the Postal Service against loss in contribution (revenue minus attributable costs). This protects against adverse impacts on other mailers (including Priority Mail customers who do not choose the presort discount option).

[7] In order to first gain experience with a manageable number of mailers, the Postal Service will limit participation to roughly 10 mailers for the first year to year-and-a-half of the experiment.

Considering its historic high growth rate, Priority Mail offers demonstrated value to customers. By giving customers access to the service at a lower price, and by giving customers more choice, a presort option, with a discount, can only enhance this value (Criterion 2).

Beyond the benefits discussed in Section II.C.1, I did not consider that a presort discount for Priority Mail would materially affect delivery time. At least one mailer, however, believes that presorting can increase the average speed of delivery (Criterion 3). See the testimony of Witness Kalenka, USPS-T-3, at 7.

A Priority Mail presort classification will be desirable to both customers and the Postal Service (Criterion 5). Customers benefit from more choice and from the opportunity to lower combined mail preparation and postage costs. The Postal Service does not lose contribution (revenue minus attributable costs), and benefits from increased customer satisfaction. Society benefits from lower overall (public + private) costs.

V. Pricing Criteria

Section 3622(b) of Title 39, U.S.C. requires the Postal Rate Commission, when issuing a recommended decision on a Postal Service request for a rate or fee change, to consider the following factors:

1) the establishment and maintenance of a fair and equitable schedule;

2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;

3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class

or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

7) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

8) the educational, cultural, scientific, and informational value to the recipient of mail matter; and

9) such other factors as the Commission deems appropriate.

The proposed presort discount maintains a fair and equitable Priority Mail rate schedule (Criterion 1). The conservative 60 percent cost pass-through is intended to ensure that rates are discounted only if the Postal Service saves at least as much in sorting costs. In this event, the Postal Service does not lose contribution (revenue minus attributable costs), and there is no pressure on other (i.e., non-discounted) rates in the mail class to increase.

The proposed conservative cost pass-through of 60 percent is aimed at ensuring that revenue does not decline by any more than cost savings. As a result, Priority Mail cost coverage will be at least as high after implementation of the discount (Criterion 3). In Section II.E, annual contribution is estimated to increase by $2.7 million, and cost coverage is estimated to increase from 161.9% to 162.0%.

The proposed presort discount satisfies Criterion 6 by offering Priority Mail customers, in return for enhanced mail preparation, a discount that reflects mail processing cost savings to the Postal Service.

Finally, the proposed presort discount does not upset one of the hallmarks of the Priority Mail rate schedule – its relative simplicity (Criterion 7). The schedule features pound increments up to 70 pounds, with rates unzoned up to 5 pounds, and zoned above 5 pounds. The proposed presort discount adds three rate elements – one discount for each of three sort options. The simplicity of the rate schedule is maintained because the discounts apply equally to all rates, regardless of weight or zone.

Proposed Priority Mail Presort Discount: Estimated Volume and Financial Impacts

		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
		Priority Mail Volume (000)	Priority Mail Revenue		Priority Mail Attributable Cost		Priority Mail Contribution To Institutional Cost		Priority Mail Cost Coverage
			Total ($000)	Per Piece	Total ($000)	Per Piece	Total ($000)	Per Piece	
(1)	Test Year, Before Experiment	1,243,245	$5,680,265	$ 4.569	$3,509,283	$ 2.823	$2,170,982	$ 1.746	161.9%
	Test Year, After Experiment								
	From Volume								
(2)	Not Discounted (Existing Volume Only)	1,224,596	$5,595,061		$3,456,644		$2,138,417		
(3)	Discounted -- Existing Volume	18,649	$ 81,909		$ 47,206		$ 34,703		
(4)	Discounted -- New Volume	295	$ 1,297		$ 747		$ 549		
(5)	Total	1,243,540	$5,678,267	$ 4.566	$3,504,597	$ 2.818	$2,173,670	$ 1.748	
(6)	From Presort Fee	NA	$1	NA	$0	NA	$1	NA	
(7)	Total	1,243,540	$5,678,269	$ 4.566	$3,504,597	$ 2.818	$2,173,671	$ 1.748	162.0%
(8)	Change in Test Year, After vs. Before Experiment	295	$ (1,996)	$ (0.003)	$ (4,686)	$ (0.004)	$ 2,689	$ 0.002	0.2%
	Inputs:								
(9)	*Existing Volume That Will Take the Discount*	1.5%							
(10)	*Price Elasticity of Demand*	-0.819							
	Per-Piece Cost Avoidances								
(11)	*ADC*	$ 0.193							
(12)	*3-Digit*	$ 0.261							
(13)	*5-Digit*	$ 0.420							
	Presort Discounts (Per Piece)								
(14)	*ADC*	$ 0.12							
(15)	*3-Digit*	$ 0.16							
(16)	*5-Digit*	$ 0.25							
(17)	*Annual Presort Fee*	$125							
(18)	*Number of Participating Mailers*	10							

Notes For Calculations

Source for 1a, 1b, 1d, 1f: Docket No. R2000-1, Appendix G, Schedule 1
1c = 1b/1a
1e = 1d/1a
1g = 1f/1a
1h = 1b/1d
2a = 1a x (1 - 9a)
2b = 2a x 1c
2d = 2a x 1e
2f = 2b - 2d
3a = 1a x 9a
3b = 3a x (1c - ((14a + 15a + 16a)/3))
3d = 3a x (1e - ((11a + 12a + 13a)/3))
3f = 3b - 3d
4a = 3a x ((-((14a + 15a + 16a)/3)/1c)/2) x 10a
4b = 4a x (1c - ((14a + 15a + 16a)/3))
4d = 4a x (1e - ((11a + 12a + 13a)/3))
4f = 4b - 4d
5a, 5b, 5d, 5f = Row 2 + Row 3 + Row 4
5c = 5b/5a
5e = 5d/5a
5g = 5f/5a
6b = 17a x 18a
6f = 6b - 6d
7a, 7b, 7d, 7f = Row 5 + Row 6
7c = 7b/7a
7e = 7d/7a
7g = 7f/7a
7h = 7b/7d
Row 8 = Row 7 - Row 1
Row 9: See Section II.E
Row 10 source: Docket No. R2000-1, USPS-T-8 at 21.
Rows 11-13: See Table 1 in Witness Levine's Testimony, USPS-T-2
Rows 14-16: See Section II.A
Row 17: See Section II.E
Row 18: See Section II.B